No. 15,982

United States Court of Appeals

For the Ninth Circuit

LESLY COHEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

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OPINION OF THE TAX COURT.

The opinion of the Tax Court is printed in 1957 (P-H) T.C. Memo. Dec. Par. 57.172 and is set forth in the Transcript of Record,* pages 206-248.

JURISDICTION OF THE COURT.

The Petitioner has petitioned this Court for review of the decision of the Tax Court of the United States, entered December 12, 1957, in accordance with its findings of fact and memorandum opinion promul-

*Unless otherwise stated all page references are to the Transcript of Record.

gated September 12, 1957, and reported in 1957 (P-H) T.C. Memo. Dec. Par. 57,172. The case involves liability for income taxes for the years 1948, 1949, and 1950, and the Petitioner's income tax returns for those years were filed with the Collector of Internal Revenue in San Francisco, which is located within the Ninth Circuit. This Court has jurisdiction to hear this petition for review under the provisions of Section 1141 of the Internal Revenue Code.

STATUTES INVOLVED.

Internal Revenue Code (1939):

Sec. 22.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Internal Revenue Code (1939):

Sec. 1112.

Fraud.—In any proceeding involving the issue whether the Petitioner has been guilty of fraud

with intent to evade the tax, the burden of proof in respect of such issue shall be upon the Commissioner.

STATEMENT OF THE CASE.

The findings of fact by the Tax Court are set forth here in full. We have inserted brackets around those findings to which the Petitioner takes exception.

"Petitioner, Lesly Cohen, during the taxable years in controversy herein, resided in San Francisco, California, and was unmarried. Petitioner filed his individual tax returns for the calendar years 1948 through 1950, inclusive, on a cash basis with the then Collector of Internal Revenue for the First District of San Francisco, California.

"Lesly was born and educated in San Francisco. He worked on a local newspaper, the San Francisco Bulletin, as a copy boy, and eventually became a sports writer and member of the sports staff. About 1934, when the Bulletin was sold to another publisher, Petitioner became a free-lance writer on sports subjects, editing boxing magazines and doing publicity work for various athletic events.

"During the taxable years in question, Petitioner lived modestly in his mother's home with two brothers and two sisters.

"During World War II, Lesly was inducted into the United States Army. Upon his discharge, he returned to California and soon thereafter became ac-

quainted with Coplin, who owned and operated the Kingston Club, (111 Ellis Street) in San Francisco. A 'card room' was maintained as part of the club's operations. The same premises were used by Coplin for his 'betting commissioner' business, which consisted largely of placing bets on horse races on a commissioner basis. The latter venture was in violation of both State and local law. Coplin, desirous of expanding his gambling activities to embrace other athletic events, invited Petitioner to join his betting commissioner enterprise as a limited partner.

"In the latter part of 1947, Coplin died, and about January 1948, Lesly took over the operation of the Kingston Club. Thereafter, until the latter part of 1951, when the Federal Gambling Stamp Tax law was put into effect, Lesly operated the club's card room and betting commissioner activities as sole proprietor. During the years 1948, 1949 and 1950, Lesly's activities as betting commissioner included not only horse racing, but other sports events. He was unable to estimate what proportion of the bets handled by him grew out of horse racing and what out of other sports events. Petitioner's activities as betting comissioner, and his operation of the card room were his only income-producing activities during the years in question, other than a small amount of income derived from investments in securities with his brother Herbert. [In his personal gambling activity at the Film Row Club, his losses exceeded his gains.] The gains and losses from his limited activities as bookmaker about balanced each other.

"Petitioner's primary function as betting commissioner was to obtain opposite parties to a wager, receiving for his services a 'commission' or fixed percentage of the amount involved in the wager. Ordinarily, Lesly would quote prevailing odds on horse races and other athletic events and if a customer wished to make a wager, Petitioner would attempt to locate others to accept or 'cover the bet' in the same amount. Normally, Petitioner did not accept a wager as 'placed' until he had found some other individual to 'lay off' the other side of the same event. When Petitioner was able to 'lay off' the entire amount of the bet, Petitioner's profit or loss would not depend upon the outcome of the event, but would be a fixed percentage or 'commission' of the total wager, which Petitioner retained on each bet. When able to do so, Petitioner would lay off the bet with one or more of his own local customers. When this could not be accomplished, he would lay off or cover the bet with other betting commissioners in the San Francisco Bay area and in other cities. He would not bring the customers betting on opposite sides of the same transaction into personal contact so that they could bet with each other. When Lesly located a client willing to accept the other side of a bet, he would confirm acceptance of the wager by telephone. Lesly was personally responsible for the collection of all betting commitments which he made, and had to pay the winner even if he was unable to collect from the loser. Petitioner watched his credits closely.

"The commission to Petitioner on bets handled for his own customers was five per cent on each bet

handled by him, except that on horse racing bets only the loser paid a commission. These commissions were not split. On bets laid off with other betting commissioners, the commission was usually split, half going to Petitioner. At times, he found it necessary to waive his entire commission in order to get the bet laid off with another betting commissioner.

"Occasionally, through miscalculations on Petitioner's part, or other unforeseen circumstances, he accepted a bet and could not arrange to lay it off. He then found it necessary to carry the other part of the bet. On these occasions, he acted as bookmaker to the extent that he himself carried the bet. Except for such occasional instances, he did not carry any part of the bet himself.

"Petitioner's betting commissioner enterprise was operated almost entirely on a credit basis. Comparatively insubstantial amounts of money were actually posted with Petitioner prior to the happening of the event which determined the wager. Normally Petitioner collected cash from local bettors and paid local winners in cash. Cash settlements were made with local customers following the happening of the sporting event. Settlements with other commissioners in the San Francisco area were likewise mainly in cash. Transactions with out-of-town betting commissioners were generally settled at periodic intervals by check. The periods varied, and included settlements on a daily, weekly or monthly basis, or when the account reached a certain fixed sum in favor of Petitioner or the out-of-town broker. Such settlements were in ef-

fect the balancing of accounts between Petitioner and out-of-town betting commissioners. They usually represented the net amount due from a number of bets rather than a single bet. When it was necessary for Petitioner to remit to an out-of-town broker to settle an account, Petitioner usually sent his own personal check. Occasionally he was required to send cashier's checks. Petitioner was unable to estimate what proportion of his betting commissioner transactions were with out-of-town brokers. The handling of bets of local customers as betting commissioner on a commission basis was a substantial part of Petitioner's business.

"Petitioner maintained a 'revolving fund' of about $3,000.00 in cash, which he used in making pay outs to local winners. Checks, most of which were received from out-of-town brokers, were either deposited in Petitioner's commercial bank account or were endorsed and transferred, or cashed by Petitioner. The only cash deposits in Petitioner's commercial bank account during the years in question were, in the aggregate, as follows: 1948—$430; 1949—$8,470; 1950—$13,955. Petitioner received cash from local bettors far in excess of the foregoing amounts in each of said respective years. His records of cash transactions as betting commissioner were kept only a few days until settlement was made. He never furnished to his accountant any records of his cash transactions or cash commissions received as betting commissioner. In preparing data for Petitioner's income tax returns for the years in question, neither the accountant

who assembled the data nor the accountant who prepared the returns from said data took into consideration any undeposited cash.

"Throughout the years 1948, 1949 and 1950, Petitioner maintained a commercial bank account in the name of 'Les Cohen' at the Market-Ellis Branch of the Anglo-California National Bank, San Francisco, California, where he deposited funds relating primarily to his activities as betting commissioner. The total deposits to Petitioner's commercial account in said bank for each of the years involved herein were in the following amounts:

Year	Amount
1948	$508,384.23
1949	404,118.69
1950	283,129.80

"Said deposits largely represented receipts from other betting commissioners in settlement of accounts.

"The foregoing deposits consisted almost entirely of checks. During the entire three-year period in question the total amount of cash included in said deposits (detailed *supra* by years) was less than $25,000.00. Deposits totaling $2,905 were made to said account on January 3, 1951.

"During each of the years in controversy, Petitioner received a large number of checks payable to 'Les Cohen' which were endorsed by him but not deposited. The total amounts thereof and the respective years in which received were as follows: 1948—$120,974.75; 1949—$107,712; 1950—$22,613.75. These undeposited

checks likewise largely represented settlement of accounts.

"Petitioner made payments by check in the settlement of accounts with out-of-town bettors totaling $292,283.46 in the year 1950.[1]

"During the taxable years in question, Petitioner did not maintain any permanent or detailed records or formal books reflecting gross commissions or gross receipts and disbursements from his betting commissioner activities. Petitioner was apprehensive that the possession of such records would be both incriminating to him and embarrassing to his customers if they fell into the hands of law enforcement officers. For his own reference purposes, however, he kept a daily 'master sheet' at the Kingston Club setting forth the transactions which he handled as betting commissioner. On a busy day, approximately 100 wagers were recorded thereon. After a day or two, when the master sheets had served their immediate purpose, they were destroyed to avoid possible seizure and use as evidence by police authorities. The effect of such destruction was likewise to render it impossible to make an accurate determination of the amount of his commissions received as betting commissioner. No record of such commissions was maintained by Petitioner.

"Petitioner retained George T. Murton (formerly the accountant for the Kingston Club during the years

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[1]Petitioner, in his proposed Finding No. 50, and Respondent, in his proposed Finding No. 83, take the position in effect that payments in unspecified amounts were made under similar circumstances in 1948 and 1949.

Coplin operated the club) to maintain its records, and Murton, or Evje, an accountant in Murton's firm, performed such service for Petitioner during the years in question.

"Murton's procedure was to go to the Kingston Club at least once a month and take off the record of income and disbursements from the card room. He also collected memorandum sheets upon which the Petitioner had noted daily cash expenditures. Receipts or paid bills were usually attached.

"Murton took the bank statements and cancelled checks and reconciled the bank statements with the check book stubs.

"The books of account of the card room were either used at the card room by Murton or taken to his office and returned to the card room where they were kept.

"The bank statements, cancelled checks, and memoranda of cash expenditures were kept by Murton either at his home or in his office.

"Murton compiled the results of his accounting work in a so-called ledger which was actually a compilation on columnar work sheets.

"Murton's method of arriving at Petitioner's gross income at the end of each year was as follows: He subtracted the amount in the bank at the beginning of the year from the amount in the bank at the end of the year. He then added to the net increase or decrease in the bank balance all of the expenses of the business and all of the withdrawals made by or for the

Petitioner. The result was considered Petitioner's gross income from the Kingston Club.

"The accountants disregarded cash receipts (other than those deposited and reflected in the bank balance) and also disregarded cash pay outs except those pay outs substantiated by a memorandum from Petitioner. This was done on the theory that the $3,000 revolving fund remained approximately the same throughout the period.

"From the gross income thus arrived at Murton would deduct the Petitioner's deductible expenses.

"[Petitioner did not inform Murton that he received a substantial amount of checks in each of the years in question in connection with his business as betting commissioner which he endorsed but did not deposit.]

"For about five months in 1950, while Murton was ill, Evje acted in his place and followed the same methods. Evje never saw any books recording cash receipts or betting records relating to Petitioner's activities as betting commissioner. Murton died some time in 1951.

"All business expenses listed on Murton's summaries and claimed as deductions on Petitioner's returns were allowed by Respondent.

"Annual summary sheets were prepared by Murton and furnished to Petitioner and mailed to Calegari, a certified public accountant who prepared Petitioner's income tax returns. The summary sheets for the three years here involved were furnished by Murton to

Calegari and were used by the latter in the preparation of said income tax returns. Calegari did not keep any books or records for the Kingston Club operations or for any of Petitioner's betting commissioner activities. The only records maintained by Calegari relating to Petitioner's financial affairs was a set of books for Lesly's investment in various stocks and bonds, which he held as a joint venturer or partner with his brother Herbert.

"In the preparation of Petitioner's income tax returns for the years in question, Calegari was not given access to any books or records that may have been maintained with respect to the Kingston Club or for any of Petitioner's betting activities. In preparing Petitioner's income tax returns, Calegari relied on the annual summary sheets and profit and loss statements of the Kingston Club operations, which were sent to him by Murton.

"About the end of 1950, Petitioner's Federal income tax returns for the years 1948 and 1949 were audited by Internal Revenue Agent Parenti. The bank statements, cancelled checks and memoranda of cash expenditures referred to above, used in the preparation of the summary sheets for 1948 and 1949 by Murton, had been kept by the latter either at his home or in his office, and were made available to Parenti.

"Parenti based his examination of Petitioner's returns for 1948 and 1949 entirely on information and data furnished by Evje of Murton's office. After Parenti audited Petitioner's returns for the years

1948 and 1949, he prepared and filed a report indicating deficiencies as follows: 1948—$5,505.67; 1949—$4,689.23.

"At the time of the trial in the instant case, the bank statements and cancelled checks for the years 1948 and 1949 could not be found. Petitioner was able to produce only his cancelled checks for the last 11 months of 1950 and bank statements for the year 1950.

"In 1952, Internal Revenue Agent Glenn Adrian conducted an original examination of Petitioner's return for 1950 and a re-examination of his 1948 and 1949 returns. At this time there was a nation-wide investigation of betting commissioners and others engaged in gambling activities. As a result of this drive, Adrian had acquired, at the time of his investigation, photostats of checks paid to or endorsed by 'Les Cohen,' which had been received from other revenue agents' offices throughout the United States. Many of said checks had been endorsed and cashed by Petitioner and had not been deposited in his commercial bank account. This information had not been available at the time of Parenti's examination.

"Adrian obtained authorization from the Commissioner of Internal Revenue for a re-examination of Petitioner's returns for 1948 and 1949, and a copy of said letter was furnished to Petitioner. At the beginning of his examination, Adrian contacted Calegari and was advised by him that Petitioner's attorney had all of Petitioner's existing books and records. Later, an agent of the Intelligence Division of the

Internal Revenue Service communicated with Petitioner's attorney and was informed that the attorney had all of Cohen's books in his office. In May 1952, Adrian caused a registered letter to be sent to Petitioner requesting that he produce his records, and a follow-up letter was sent to Petitioner in September of 1952. Petitioner neither answered the letters nor produced his books and records. Thereafter, Adrian contacted Petitioner's attorney who informed the agent that he would look at the records in his possession and would let Adrian know whether he could see them. Later the attorney informed Adrian that he had looked at the records and that he would not show Adrian anything.

"Adrian proceeded to make his audit on the basis of third-party records to the extent that they were available. The available records were (1) bank deposit tags which showed dates and amounts of deposits and a number identifying the banks on which the deposited checks were drawn, but no names identifying the makers of the checks; (2) copies of bank statements of Petitioner's accounts showing total deposits, and amounts and dates of payment of checks drawn on the account, but without names or other identification of payees; (3) photostatic copies of checks payable to Les Cohen obtained from other internal revenue agents' offices, and (4) a transcript of an account on the books of the Film Row Club showing Petitioner's wins and losses from [personal] bets at that club.

"Petitioner's wins and losses from gambling at the Film Row Club were as follows:

Year	Amount Won	Amount Lost
1948	$61,695.00	$79,075.00
1949	63,500.00	69,912.50

"Respondent computed Petitioner's taxable income for the years in question by the so-called bank deposit method. He determined that all monies deposited in the commercial bank and all checks received and endorsed but not so deposited (to the extent he had knowledge of them at the time the statutory notice was mailed) and all wins from the Film Row Club constituted income. [Because of lack of substantiation, no deductions were allowed for pay outs or losses.] None of the deductions claimed on Petitioner's returns were disallowed.

"Revenue Agent Adrian did not attempt to compute Petitioner's net income by the so-called net worth method because Petitioner dealt in large sums of cash and the agent did not feel that he could accurately determine net worth for that reason and also because, having been refused Petitioner's books, he would not know how Petitioner made his investments.

"In Petitioner's tax returns for 1948 through 1950, inclusive, on Schedule C, page 2 (profit or loss from business), the nature of the business was stated to be 'brokerage.'

"Gross profits (listed as total receipts) from the Kingston Club operations are reported on Petitioner's tax returns for the years 1948 and 1949 in the amounts of $56,795.13 and $66,274.91, respectively. On Petitioner's original income tax return for the year 1950,

he reported gross profit (listed as total receipts) from Kingston Club in the amount of $1,836.28, and a net loss of $26,687.91. On July 28, 1954, Petitioner filed an amended return for the year 1950 on which he reported gross income (listed as total receipts) from Kingston Club of $8,207.71 and a net loss of $15,125.75.

"During the years involved herein, Lesly had a safe deposit box at the Bank of America, Day and Night Branch.

"During each of the taxable years in question, Petitioner received substantial commissions in cash from local customers. His settlements with local betting were almost entirely in cash, and reflected his share of commissions.

"Petitioner's gross income from his activities as betting commissioner and the operation of the Kingston Club card room for the respective years in question did not exceed the following: 1948—$167,000; 1949—$145,000; 1950—$108,000.

"[Petitioner, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room.

"A part of the deficiency for each of the years involved was due to fraud on the part of Petitioner with intent to evade taxes within the meaning of Section 293(b).]"

PETITIONER'S OBJECTIONS TO FINDINGS.

Petitioner objects to the Court's reference to personal gambling activity as unsupported by the record. Petitioner's position is that the transactions with the Film Row Club were exactly the same as the transactions that Petitioner had with the various other betting establishments whose names appear in the Stipulation of Facts.

Petitioner objects to the statement that Petitioner did not inform Murton that he received a substantial number of checks in each of the years in question in connection with his business as betting commissioner, which he endorsed but did not deposit. The evidence taken as a whole shows that Murton was completely conversant with Petitioner's method of operation.

We object to the finding that the Respondent disregarded pay outs or losses for lack of substantiation. Petitioner contends that the Respondent's action was politically inspired and was part of the national upheaval in 1952, and that the purpose of the Respondent's fantastic determination and the publicity attending the levying of the Jeopardy Assessment were designed to divert public attention from the current attacks on the Bureau of Internal Revenue

And finally, Petitioner completely disagrees with the last two paragraphs of the Court's findings. There is absolutely no evidence that the Kingston Club card room did not correctly report its income and the Respondent has never contended otherwise. There is no evidence to support the finding that Petitioner sub-

stantially understated his income from his activities as a betting commissioner and the Court's findings in that regard are wholly dependent upon an alleged presumption in favor of the validity of the Respondent's determination. Petitioner contends that the finding of fraud is contrary to the evidence. Petitioner strongly contends that the Court's finding that Petitioner understated his income as a betting commissioner is against a clear preponderance of the evidence. The available records strongly support the reliability of Petitioner's income tax returns. The audit made by the Internal Revenue Agent Parenti, through years 1948 and 1949, strongly supports Petitioner's contention that his returns for those years were accurate. Petitioner placed in evidence his net worth statement, which is consistent with his reported income. Petitioner's manner of living, personal expenses and non-deductible expenditures were all consistent with his income as disclosed by his income tax returns. Petitioner's own testimony was strong and clear and in the absence of contradictory testimony the Tax Court was not at liberty to disregard it.

The questions presented on this appeal are:

First: Did the Tax Court err in holding that Petitioner failed to show that the Respondent's determination of deficiency was arbitrary and invalid, and that the burden of proof was on Petitioner to prove that he did not owe the amounts determined by the Commissioner?

Second: Are there material errors in the Tax Court's findings of fact, and

Third: Did the Tax Court err in holding that Respondent affirmatively proved that a part of the deficiency in each year was due to fraud with intent to evade tax.

SPECIFICATIONS OF ERROR.

I. The Tax Court erred in holding that Petitioner failed to show that the Respondent's determination of deficiencies was arbitrary and invalid and that the burden of proof was on Petitioner to prove that he did not owe the amounts "determined" in the deficiency notice.

II. The Tax Court's findings of fact are erroneous in several material matters:

(1) The statement that Petitioner engaged in *personal* gambling at, or with, the Film Row Club finds no support in the record.

(2) The finding that Respondent's treatment of the Film Row Club wins and losses was not arbitrary or unreasonable is contrary to law.

(3) The various findings that state or imply that Petitioner withheld essential information from his accountant are unsupported by the record.

(4) The finding that Petitioner substantially understated income from the Kingston Club Card Room is contrary to the record and raises an issue which the Respondent has conceded.

(5) The finding that the Petitioner in his income tax returns for the years in question substantially understated the income from his activities as betting

commissioner is a general conclusion and is not specific or definitive enough to enable the court of review to pass upon its validity (221).

(6) The finding that Petitioner failed to establish that his income from his activities as betting commissioner and his operation of the Kingston Club Card Room was not less than $167,000.00 in 1948; $145,000.00 in 1949; and $108,000.00 in 1950 is a mere conclusion unsupported by specific and definitive findings of fact (221).

(7) The finding that Petitioner received commissions in cash from local bettors in amounts not less than $69,000.00 in 1948; $60,000.00 in 1949; and $44,000.00 in 1950, is a general conclusion, not supported by specific, definitive findings of fact (241).

(8) The finding that cash received from local bettors was retained by Petitioner and therefore not reported as income under Murton's method of reporting income is contrary to the evidence.

III. The Tax Court erred in holding that Respondent has affirmatively proved that a part of the deficiency in each year was due to fraud with intent to evade tax.

SUMMARY OF ARGUMENT.

I. The Tax Court erred in holding that Petitioner failed to show that the Respondent's determination of deficiency was arbitrary and invalid, and that the burden of proof was on Petitioner to prove that he did not know the amount determined by Commissioner.

Petitioner contends that the record shows that the Respondent's determination was arbitrary and excessive and consequently that the presumption in favor of Respondent's determination disappeared. The judgment of the Tax Court is wholly dependent upon the existence of the presumption. The Court did not find unreported income in any specific amount; it merely found that it is not likely that Petitioner received gross commissions in excess of specific sums and "that Petitioner has failed to establish a lesser amount."

The Tax Court holding that Respondent's determination is not arbitrary and invalid is contrary to the record and to the Court's own findings of fact and is contrary to law.

1. The size of the deficiencies, the wording of the deficiency notice and the manner that the assessment was levied, all show that the Respondent intentionally determined an arbitrary and excessive assessment as a part of the national crackdown on illegal gambling in 1952.

2. Information available to Respondent as a result of the Parenti audit showed that the determination was intentionally, or recklessly, arbitrary and excessive.

3. Respondent knew that Petitioner was a betting commissioner and that his gross income would be but a small percentage of his gross receipts.

4. Respondent knew that bank deposits and checks cashed or endorsed would have no reason-

able relationship to Petitioner's income from commissions.

5. Respondent's action in including wins and disregarding losses from the Film Row Club shows that his policy was to "determine" the highest possible amount and attempt to throw upon the Petitioner the burden of proving that the determination was wrong.

The Petitioner relies upon the well-established rule that the taxpayer meets the burden of proving the Commissioner's determination invalid when he shows that the determination was arbitrary and excessive. The taxpayer is not required to prove, in addition, that he owes no tax, nor is he required to prove the correct amount of the tax that he owes.

II. The Tax Court's findings of fact are erroneous in several respects:

1. The finding that Appellant engaged in personal gambling at the Film Row Club is contrary to the evidence. Petitioner's transactions with the Film Row Club were on exactly the same basis as his transactions with Corbett's or Harold's Club, or any of the other betting establishments mentioned in the evidence. A correct finding in this particular would tend to show that the Commissioner's determination was arbitrary and invalid.

2. The finding that Respondent's treatment of the Film Row Club losses was not arbitrary or unreasonable is contrary to law.

3. Several findings state, or imply, that Petitioner withheld essential information from his accountants. The undisputed testimony in the record shows that Petitioner's accounting system was set up by the accountant, Murton, and that Murton devised this system of accounting to enable Petitioner to correctly report his income without the necessity for maintaining records of individual transactions.

4. The finding that Petitioner substantially understated income from the Kingston Club card room is contrary to the record and raises an issue, which the Respondent did not raise.

5. The finding that Petitioner substantially understated income from his activities as betting commissioner is a conclusion which is stated by the Court to be based upon the consideration of various enumerated factors; however, the Court has made no specific, definitive findings which show how much weight, or valuation was placed upon the various factors, so that it is impossible for the court of review to tell from the findings whether the Tax Court's conclusion was valid, or not.

6. The finding that Petitioner failed to establish that his income from his activities as betting commissioner, and the operation of the Kingston Club card room, was not less than $167,000 in 1948; $145,000 in 1949; and $108,000 in 1950, is contrary to law and is not supported by the record. Again, the finding is a conclusion from a summary of other facts in evidence, but the Tax Court failed to make any specific and

definitive findings by which this Court could check the validity of its conclusion.

7. The finding that Petitioner received commissions in cash from local bettors in amounts not less than $69,000 in 1948; $60,000 in 1949; and $44,000 in 1950, is contrary to the evidence. The finding is a mere conclusion based upon vague computations and assumptions and which do not contain sufficient information to enable the reviewing Court to pass upon the validity of the finding.

8. The finding that cash received from local bettors was retained by Petitioner in cash and not reported as income under Murton's method of reporting income is contrary to the evidence. It is self-evident that if the cash revolving fund did not exceed $3,000 at the end of any tax year, Murton's method of accounting would correctly reflect all of Petitioner's income. There is no evidence in the record from which it could reasonably be inferred that Petitioner retained cash in excess of the $3,000, which is admitted.

III. The Tax Court erred in holding that Respondent has affirmatively proved that a part of the deficiency in each year was due to fraud with intent to evade tax. The Tax Court correctly states the applicable rules of law, i.e., "the burden of proof with respect to fraud is upon the Respondent, and he must establish fraud on the part of Petitioner by clear and convincing evidence". "We recognize that Respondent cannot meet his own burden of establishing fraud on the basis of Petitioner's failure to discharge the

burden of proving error in the determination of deficiencies, and we do not, of course, rest our finding of fraud on that basis. The existence of fraud with intent to evade tax must be affirmatively established by Respondent." The basis of the Court's conclusion that there was a substantial understatement of income on Petitioner's return for each of the taxable years in question is stated by the Court as follows, "Taking into consideration the minimum volume of lay off bets indicated by the deposit of checks and money orders from out-of-town betting commissioners; undeposited checks and money orders from the same sources; checks of Petitioners to betting ocmmissioners; the fact that the remittances to and from Petitioner usually represented the settlement of accounts, rather than individual bets; the added fact that the Petitioner's local cash business was a substantial part of his betting commissioner activities, recognizing the percentages he received (and making allowance for splitting of commissions on out-of-town business, occasional foregoing of commissions, occasional losses, and the fact that Petitioner received commissions on horse race bets only from the loser . . .)". The Court refers to its consideration of the above-named factors as an "analysis of the record". If it is really an analysis, and not merely "an educated guess", the details of the computation should be set forth in specific and definitive findings of fact. For the purpose of making a "half arbitrary, half intelligent" guess under the *Cohan* rule, the Tax Court is permitted to make general estimates. In determining the existence

of fraud with intent to evade tax, all of the facts necessary to establish the fraud must be clear and convincing. The Petitioner and the court of review are entitled to know what the Tax Court established as the total volume of business transacted by Petitioner; what rate of percentage was applied; and what allowance was made for splitting commissions; what allowance was made for foregoing commissions; and what allowance was made for occasional losses; and what allowance was made for the fact that Petitioner received commissions on horse race bets only from the loser.

The Court may not reject the Petitioner's testimony to the effect that his returns were honest, correct and complete where there are no facts in the record to contradict such testimony. The truth of Petitioner's testimony is corroborated by available records, the audit of Internal Revenue Agent Parenti for two of the three years in question, the checks and bank statements available for the year 1950, Petitioner's net worth, manner of living and personal expenses.

ARGUMENT.

I. THE TAX COURT ERRED IN HOLDING THAT PETITIONER FAILED TO SHOW THAT THE RESPONDENT'S DETERMINATION OF DEFICIENCIES WAS ARBITRARY AND INVALID AND THAT THE BURDEN OF PROOF WAS ON PETITIONER TO PROVE THAT HE DID NOT OWE THE AMOUNTS "DETERMINED" IN THE DEFICIENCY NOTICE.

The Petitioner relies upon the well-established rule that the Taxpayer meets the burden of proving the Commissioner's determination invalid when he shows

that the determination was arbitrary and excessive. The taxpayer is not required to prove in addition that he owes no tax, nor is he required to prove the correct amount of the tax that he owes. The Respondent long contended that the burden is on the taxpayer not only to prove that the Commissioner's determination is erroneous, but to show the correct amount of the tax. This argument was finally laid to rest by the Supreme Court in *Helvering v. Taylor,* 293 U.S. 507, 55 S. Ct. 287, 79 L. ed. 623:

> "We find nothing in the statutes, the rules of the board, or our decisions, that gives any support to the idea that the Commissioner's determination, shown to be without rational foundation and excessive, will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount. While decisions of the lower courts may not be harmonious, our attention has not been called to any that persuasively supports the rule for which the Commissioner here contends.
>
> Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid (citations omitted). Frequently, if not quite generally, evidence adequate to overthrow the Commissioner's finding is also sufficient to show the correct amount, if any, that is due. . . . But, where as in this case, the taxpayer's evidence shows the Commissioner's determination to be arbitrary and excessive, it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him."

The rule above quoted has been followed in many subsequent cases including the following:

Federal National Bank of Shawnee v. Commissioner, 180 Fed. 2d 494, 39 AFTR 25.

A. & A. Tool & Supply Co. v. Commissioner, 182 Fed. 2d 300, 39 AFTR 517.

Gasper v. Commissioner, 225 Fed. 2d 284, 47 AFTR 1848.

H. T. Rainwater, 23 TC 450.

The Respondent's Deficiency Notice, dated November 25, 1952, with attached statement, is set forth at pages 7-12 of the Transcript. The letter states that the assessment of such deficiency, or deficiencies, has been made under the provisions of the Internal Revenue laws applicable to jeopardy assessments. There follows a statement of the alleged deficiency and penalty for each of the three years, followed by the explanation, "The determination of your tax liability and penalty is made on the basis of information on file in this office." (9). There are two additions to income for the year 1948: (a) interest, $159.12, which is not at issue here; (b) business income, $693,189.62, and the only explanation of this adjustment is as follows, "(b) available information discloses that income in the amount of $693,189.62 was not included in the net income as reported." (9). For the year 1949, the only item in this statement is, "(a) business income, $542,-478.73", and under explanation of adjustments, "(a) available information discloses that income in the amount of $542,478.73 was not included in the net income as reported." (10). For the year 1950, the state-

ment includes the following, "(a) business income, $326,095.00", explanation of adjustments, "(a) available information discloses that income in the amount of $326,095.00 was not included in income as reported." (11).

The foregoing represents the entire determination of the Commissioner concerning unreported income, as the rest of the statement is a mere computation of taxes and penalties. The addition of the small interest item and three items of alleged business income are the only changes proposed by the Commissioner for the years in question. He does not question the deductions claimed on Petitioner's income tax returns.

On the basis of information on file in his office (but not included in the Deficiency Notice or statement) the Respondent filed a Jeopardy Assessment on the assets of the taxpayer in the fantastic sum of $1,193,511.18, plus a penalty of $596,755.59. Respondent never disclosed to Petitioner, or his counsel, what the "information" referred to in the statement was, until almost the close of the hearing before the Tax Court, when Internal Revenue Agent Glenn H. Adrian was on the stand (189-205). Respondent rested his case as soon as Mr. Adrian had testified (205).

Mr. Adrian was the Internal Revenue Agent who prepared the report which was the basis for the Commissioner's Jeopardy Assessment and determination of deficiencies (197). Mr. Adrian testified that the sums designated in the deficiency letter as additional business income were made up from three sources: (1) the Petitioner's total bank deposits, including

cash and checks; (2) the sum of a considerable number of checks which had been cashed, or endorsed, by the Petitioner and not deposited in the bank; (3) the *wins* from the Film Row Club (194, 197).

The Tax Court concedes that the wins from the Film Row Club did not constitute income (225). The net effect of the Court's other findings is that the bank deposits did not include any *unreported* income (241-242). By resolving every possible inference against the Petitioner, not more than $140,722.25 of the checks "received and endorsed" but not deposited, could represent unreported income. The Court found that Petitioner's cash commissions from local bets totalled $173,000, of which approximately $25,000 was deposited in the bank, leaving $148,000, which Petitioner is deemed to have received and retained in cash from local transactions (241). The Court found that the total unreported commissions for the three years could not have exceeded $288,721.25. If we deduct the $148,000 alleged to have been received in cash from local bettors, the greatest amount that could have been received and retained from the checks cashed would be $140,722.25 (242). Of course, the Court did not find any specific amount of unreported income. It merely said that it was satisfied that the taxpayer could not have had more unreported income than the maximum stated. The amount of income reported by the Commissioner, the maximum possible unreported commissions found by the Tax Court, and the amounts claimed by the Commissioner in his Deficiency Letter, are set forth as follows:

	Petitioner Reported	Tax Court Maximum	Commissioner Claimed
1948	$ 56,795.13	$110,204.87	$ 693,189.62
1949	66,274.91	78,725.09	542,478.73
1950	8,207.71	99,792.29	326,095.00
	$131,277.75	$288,722.25	$1,561,763.35

In spite of the fact that none of the Film Row wins, none of the bank deposits, and not more than $148,000 of the undeposited checks, could have constituted unreported income under the Tax Court's own findings, it nevertheless refused to find that the Commissioner's determination was arbitrary and excessive. It is the Petitioner's contention that the undisputed facts, as disclosed by the record in this case, show that, as a matter of law, Respondent's determination was arbitrary and excessive and that the Court below erred in holding that the burden was upon Petitioner to establish that he did not owe any deficiencies in income taxes for the years in question.

The Tax Court leans heavily upon the case of *Doll v. Glenn,* (6 Cir.) 231 Fed. 2d 186, 49 AFTR 412, and the cases cited therein, to support its holdings. Its argument is, that in the absence of books and records, the Commissioner is justified in making his determination on the basis of the bank deposit method (222), however, none of the cases cited holds that the absence of records will justify the Commissioner in using the bank deposit method in an arbitrary or unreasonable manner.

This is made perfectly clear by the Sixth Circuit, which decided the *Doll* case, in the case of *Schira v. Commissioner,* 240 Fed. 2d 672, 50 AFTR 1404, wherein the Court said,

> "Petitioners also contend that there was not sufficient evidence to sustain the assessments, which, because of the absence of books and records, were merely unwarranted estimates on the part of the Commissioner. In the absence of books and records, the Commissioner was justified in making assessments based upon other available evidence, provided they were not arbitrary or unreasonable. Doll v. Glenn, 231 F. 2d 186, 188. In the opinion of the Court, the assessments, although necessarily largely in the nature of estimates, were not arbitrary or unreasonable. Being presumptively correct, the burden rests upon the taxpayer to prove them erroneous."

The undisputed facts in this case show that the Commissioner's determination was arbitrary and excessive.

(1) The Fantastic and Unrealistic Amounts Claimed in the Deficiency Notice, the Arrogant Failure to State the Basis of the Determination in the Notice, the Deliberate Levy of a Jeopardy Assessment for $1,790,266.77, All Show That the Respondent Intentionally Determined an Arbitrary and Excessive Assessment as Part of the Nationwide Crackdown on Illegal Gambling in 1952.

The special Senate investigating committee, commonly called the Kefauver Committee, had focused the attention of the country upon the activities of betting commissioners, as well as bookmakers, numbers operators, and other types of illegal gambling. The In-

ternal Revenue service itself was under heavy attack and many of its high officials were subsequently indicted and convicted. 1952 was a presidential election year and the party out of power seized upon corruption in the Bureau of Internal Revenue as an election issue. Whatever its motives may have been, the historical fact is that the Bureau of Internal Revenue set up a special "racket squad" and commenced a nation-wide crackdown on gambling. See the testimony of Robert K. Lund, Assistant Chief, Intelligence Division, Internal Revenue Service in San Francisco (173-176). It will be noted that Mr. Lund attempted to get possession of the Petitioner's books, not in connection with any investigation of Petitioner, but in connection with investigations of other taxpayers. The information collected in the Stipulation on file in this case was gathered by income tax investigators all over the United States. The very size of the proposed deficiencies indicates a reckless disregard of Petitioner's rights. After resolving every doubt against the Petitioner under the *Cohan* rule, the Tax Court found that the highest possible amount of unreported income was less than one-fifth the amount set forth in the Deficiency Notice. Normally, the Commissioner sets forth in his Deficiency Notice at least a summary of the facts upon which he relies. The very least that he should have done in this case would have been to indicate that he was using the bank deposit method. It seems obvious that Adrian knew that he had no rational basis for the determination and by simply referring in the Deficiency Notice to "available informa-

tion'' he left the door open for the use of any information that might be acquired at any time up to the time of trial. The levying of a Jeopardy Assessment, where no jeopardy was shown to exist, indicates that the Bureau of Internal Revenue was intent upon getting all of the publicity possible out of its nation-wide crackdown.

(2) Information Available to Respondent as a Result of the Parenti Audit Shows That the Determination Was Intentionally, or Recklessly, Arbitrary and Excessive.

The Tax Court completely failed to understand the importance of the Parenti Audit and Report, in connection with the issue of whether or not the determination of the Commissioner was arbitrary. The Court merely held that the fact that a prior examination made by Revenue Agent Parenti did not develop any substantial omissions of income was of no significance (243). The Tax Court correctly points out, ''Parenti's examination and report were in no sense binding on Respondent''. On the other hand, Respondent cannot deliberately ignore the information in his own files and then claim that his determination was not arbitrary. Mr. Parenti's report is marked ''Exhibit 6'' and is worthy of careful study. It should be noted that Mr. Parenti's audit took place only a few months before that of Mr. Adrian. Mr. Parenti conducted his investigation in the manner that a normal audit would be conducted by an Internal Revenue Agent in normal times. Mr. Parenti's work sheets and audit papers must have been available to Mr. Adrian, but they were not used. The very nature of the adjust-

ments made by Mr. Parenti showed that his investigation must have been thorough. He had the bank statements and cancelled checks for 1948 and 1949, which are now lost. He had Murton's ledger and work sheets. Adjustment "(a)" for both years involved payroll taxes, showing that Parenti considered the taxpayer's deduction. Adjustment "(b)" in both years states that taxpayer understated net receipts in the amount of $5,193.84 for 1948, and $2,996.99 for 1949. Obviously, these figures ending in odd dollars and cents, came from some definite source. They indicate that Parenti attempted to audit the taxpayer's net receipts, and that he necessarily had to learn Murton's method of ascertaining income. While he did adjust some of the items, he did not indicate that as a method of accounting it was not acceptable to the Internal Revenue service. Third, Parenti's work sheets must show what items make up the alleged understatement of net receipts. It is a fair inference that if Mr. Parenti's work sheets or testimony would have been unfavorable to Petitioner he would have been called to the stand by the Respondent. Petitioner naturally assumed that Mr. Parenti would be called, since he sat in Court with the Respondent's other witnesses until the Court recessed for dinner. In "(c)" of the Parenti report, he adds $4,000.00 each year as estimated personal expenses included in business deductions. This is a round figure, candidly labeled "estimate". Since the expenses paid by check were definitely ascertainable from the checks in his hands, Mr. Parenti's estimates were necessarily concerned with

cash expenditures. Therefore, Mr. Parenti must have known of taxpayer's practice of dealing in cash. He also had an opportunity to ascertain the taxpayer's personal habits and manner of living. Yet, the year before the "heat was on", and considering the taxpayer's circumstances on the merits only, Mr. Parenti estimated personal expenditures of $4,000.00 per year. We can assume that this estimate represents his fair and considered judgment, uninfluenced by political necessities or a "national upheaval".

Mr. Parenti's audit was far from perfunctory, nor were the results negligible. In 1948, taxpayer's income tax was shown on his return as $8,357.98, and Parenti assessed an additional $5,505.66; in 1949, the returns showed a tax of $14,501.28, and Parenti assessed an additional tax of $4,689.23. In order to have made these substantial adjustments, Parenti must be deemed to have made a rather thorough audit. The record shows that he received the taxpayer's fullest cooperation and nothing was withheld from him. The only information that Adrian had that Parenti did not have was the various checks picked up over the country during the nation-wide crackdown on gambling. Since Mr. Parenti must have known that Petitioner was dealing principally in cash, and was working on a commission, the discovery of the cashed checks is not significant. If Petitioner had received cash by Parcel Post the result would have been the same. The proceeds would have gone to pay the winners in San Francisco and any excess over the usual revolving fund would have been deposited in the bank. If the

Respondent had used the available information in the Parenti file, he would have known that Petitioner worked on a commission basis and that the withdrawals by check from the checking account approximated the deposits. Respondent should not be permitted to ignore the information in the Parenti papers and then say that his Jeopardy Assessment for almost $1,800,000.00 was made in good faith.

(3) Respondent Knew that the Petitioner Was a Betting Commissioner and That His Gross Income Would Be But a Small Percentage of His Gross Receipts.

Respondent also knew that the amount set forth on line 1 of Schedule C of Petitioner's income tax returns showed net receipts, not gross receipts (Parenti report, Exhibit 6). Parenti's report is hardly necessary to establish this fact, as it is obvious that the total amount set forth on Schedule C, line 1, is treated throughout the returns as gross income, and not as gross receipts. Obviously, a betting commissioner would have to handle large sums of money, in order to make gross income in commissions equal to the amount reported by petitioner on his income tax returns. There is a definite difference in the tax law between gross income and gross receipts. A taxpayer must be prepared to prove the validity of his deductions from gross income, not from gross reecipts. This is the error in Adrian's explanation that he thought he was merely setting up Petitioner's gross income as evidenced by the bank deposits and then it would be up to the Petitioner to prove his deductions. The Tax Court correctly held that Petitioner had neither wins

nor losses and that his income was derived from commissions.

(4) Respondent Knew That Bank Deposits and Checks Cashed, or Endorsed, Would Have No Rational Relationship to Petitioner's Income From Commissions.

The Tax Court used the amount of the bank deposits and checks cashed with other information to estimate the volume of business upon which Petitioner receives commissions and on that basis found that Petitioner's commissions could not exceed sums amounting to less than one-fifth of the amount the Respondent determined. We think this case is a good example of an alarming trend among revenue agents to issue a Deficiency Notice with no rational basis in fact, with the idea that the taxpayer will be compelled to prove that he does not owe the deficiency.

(5) Respondent's Action in Including Wins and Disregarding Losses From the Film Row Club Shows That His Policy Was to Determine the Highest Possible Deficency and Throw Upon the Petitioner the Burden of Proving That the Determination Was Wrong.

Adrian's handling of the Film Row Club transactions casts grave doubts upon the truth of his statement that he would have been glad to have allowed pay outs against the bank deposits, but had no information concerning any pay outs. He had just as much information about the Film Row Club losses as he had about the gains. The schedule upon which he relied was secured from another revenue agent and was not in any degree binding upon this Petitioner. Adrian was compelled to admit that he had just as much reason to believe that the statement

of losses was correct as he had to believe that the statement of wins was correct.

The Tax Court was under a complete misapprehension concerning Petitioner's transactions with the Film Row Club. It refers to Petitioner's *personal* gambling. Petitioner testified that he never intentionally gambled and the Court so found. We are utterly at a loss to see how the idea of personal gambling got into the Court's findings of fact. The Film Row Club was no different than Harold's Club, Corbett's, or any of the other betting establishments whose names appear in the record. The only difference is that Respondent's agent happened to get hold of a schedule of wins and losses from that particular account. While the Tax Court's reasoning was clearly erroneous, its refusal to allow the excess of loss over wins was correct. Incidentally, Petitioner never contended before the Tax Court that the excess of losses should have been allowed as a deduction. We took the position there, as we do here, that both wins and losses are immaterial. We have no doubt that if similar schedules were available for all of Petitioner's accounts, the aggregate wins and losses would balance. The Tax Court opinion recognizes this fact in connection with all transactions, except the Film Row Club and there is nothing in the record to justify giving different treatment to the Film Row Club transactions. Neither the wins nor the losses in any of Petitioner's transactions were relevant except to the extent that they might indicate the volume of business upon which Petitioner received commissions (151).

The net result of the Tax Court's holding in connection with the Commissioner's presumption is, that no matter how fantastic and completely unreasonable the Commissioner's determination of deficiencies is, in the absence of books and records the Commissioner's determination is not arbitrary. The authorities on which the Tax Court relies do not support that contention. *Schira v. Commissioner,* supra. We respectfully submit that a consideration of the entire record shows that the Commissioner's determination was arbitrary and excessive and therefore, that the Court's ruling that the burden of proof was on Petitioner to show that he did not owe the deficiencies assessed against him, was incorrect.

In the recent case of the *Estate of Albert E. MacCrowe, et al., v. Commissioner,* 1 AFTR 2d 58-886, 252 F. 2d 293, the Fourth Circuit remanded the case to the Tax Court because there were no findings upon which the Tax Court's determination could be based. The Commissioner had arrived at deficiencies in the reported income of a deceased physician for the years of 1948 and 1949 by estimating the number of patients operated on by the physician on the basis of morphine tablets purchased by him and multiplying this by a charge of $400.00 per patient. This resulted in a total of $192,000.00 for 1948 and $96,000.00 for 1949. The Tax Court found these determinations to be incorrect, but that the physician's gross income from medical practice was $115,000.00 for 1948 and $55,000.00 for 1949, without, however, finding the facts upon which this determination was based. In re-

manding the case to the Tax Court for additional findings, the Court said:

> "We find, however, the same defect in the determination of gross income from medical practice as when the case was originally before us. The income as determined by the Commissioner on the basis of morphine tablets purchased and $400 charge per patient is still $192,000 for 1948 and $96,000 for 1949; neither of these amounts is accepted by the Tax Court; any presumption as to the correctness of the Commissioner's determination is accordingly out of the case; and the Tax Court has made no findings whatever upon which its determination of gross income of $115,000 and $55,000 from medical practice can be supported, nor does it give any reason for the figures at which it arrives."

We respectfully submit that a consideration of the entire record shows that the Commissioner's determination was arbitrary and excessive and therefore, that the Court's ruling that the burden of proof was on Petitioner to show that he did not owe the deficiencies assessed against him, was incorrect.

II. THE TAX COURT'S FINDINGS OF FACT ARE ERRONEOUS IN SEVERAL MATERIAL MATTERS.

In Part I of this Argument, Petitioner has discussed his objections to the Tax Court's findings that Respondent's original determination was not arbitrary and excessive. In Section III we will discuss those findings involved in the fraud issue. This section deals principally with errors and omissions in

the Tax Court's findings in connection with deficiencies in income taxes. Even though the Tax Court reduced Respondent's claim to less than one-fifth of the deficiencies claimed, the amount of tax determined by the Tax Court to be owing by this Petitioner still greatly exceeds Petitioner's entire gross income for the three years in question. Petitioner respectfully contends that this case should be remanded to the Tax Court because of the following errors and omissions:

(1) The Statement That Petitioner Engaged in Personal Gambling At, or With, the Film Row Club Finds No Support in the Record.

We refer to the statements of the Court set forth on page 209, "In his personal gambling activity at the Film Row Club, his losses exceed his gains", and on page 219, "and (4) a transcript of an account on the books of the Film Row Club showing Petitioner's wins and losses from personal bets at that club." The only evidence in the record in connection with the Film Row Club is found in the testimony of Internal Revenue Agent Glenn H. Adrian. The only part of that testimony which is relevant to this finding is as follows (194-195):

> "Q. (by Mr. Nyquist): You mentioned the Film Row Club. Will you tell us what information you had about the Film Row Club?
>
> A. There was an examination made by our office of the Film Row Club, and during the examination there was given to the agent the records, and in the records were bets with Mr. Lesly Cohen, and the agent gave to me a tran-

> script of the wins and losses, and I used that transcript, as I say. I took the wins and put them in my schedule as gross income, or as income."

It is respectfully submitted that there is nothing in the record from which a reasonable inference could be drawn that Petitioner's business with the Film Row Club was any different than it was with the other betting establishments with whom he did business. For example, the Horseshoe, Nationwide Sport Service, Baseball Headquarters, and the other firms whose names appear in the Stipulation of Facts. The Petitioner testified that he did not intentionally gamble (160) and the Court correctly found:

> "Occasionally, through miscalculations, on Petitioner's part, or other unforseeen circumstances, he accepted a bet and could not arrange to lay it off. He then found it necessary to carry the other part of the bet. On these occasions, he acted as a bookmaker to the extent that he himself carried the bet. Except for such occasional instances he did not carry any part of the bet himself." (210-11).

(2) The Finding That Respondent's Treatment of the Film Row Club Wins and Losses Was Not Arbitrary or Unreasonable Is Contrary to Law (224).

The Tax Court accepted Adrian's explanation (195) that losses from the Film Row Club were disallowed because they were unsubstantiated and also because the year of payment was not shown (224). The Tax Court said that while Adrian's conclusions were erroneous, they were "tenable". Adrian's explanation

would have some color of plausibility if it were true that Petitioner's Film Row Club bets were personal. Once the unwarranted assumption that the Petitioner's Film Row betting was personal is eliminated, Adrian's explanation makes no sense at all. What facts were available to Adrian when he decided to call the wins income and disregard the losses? The Tax Court found that he had acquired photostats of the checks paid to, or endorsed by, Les Cohen from other Revenue Agents throughout the United States (218). He knew that Petitioner was a betting commissioner, doing an extensive local and out-of-town business and he knew that Petitioner dealt in large sums of cash (196). He knew that Petitioner had reported a large amount of gross income on his income tax returns for the years under investigation. He had access to the Parenti report, Exhibit 6. The schedule which he had received third-hand was not placed in evidence, but Adrian admitted that there was just as much reason to believe the loss figures as the win figures (199). In the light of the information available to him, Adrian knew, or should have known, that neither the wins nor the losses would have affected Petitioner's gross income from commissions. If Adrian had desired to deal fairly with the taxpayer, he would have found that Petitioner had gross income from the Film Row Club transactions equal to five percent of both wins and losses and thrown upon Petitioner the burden of showing which bets were horse race bets, in which only the loser paid the commission.

(3) The Various Findings That State or Imply That Petitioner Withheld Essential Information From His Accountant Are Unsupported by the Record.

The substance of the Tax Court's findings is that Petitioner did not inform Murton that he was dealing largely in cash, or that he received a substantial amount of checks in each year which he endorsed but did not deposit in the bank (243, 216). This finding is contrary to the evidence before the Court. The evidence shows, and the Tax Court found, that Petitioner maintained a $3,000.00 cash revolving fund and that Murton's accounting method assumed that this figure was constant (212). Murton knew, of course, that a betting commissioner dealt largely in cash. The evidence shows that he was in Petitioner's place of business at least once a month where he had an opportunity to observe the manner in which the transactions took place (214). The checks which Petitioner cashed, or endorsed, had no more significance from the standpoint of income than any other cash. It is perfectly correct to state that Petitioner never told Murton how much cash he handled, or how many checks he cashed. The understanding between them was that cash in excess of the revolving fund was deposited in the bank. This method of accounting for income had been devised by Murton and installed by him when the business was owned by Petitioner's predecessor for the very purpose of obviating the necessity of maintaining a detailed record of the cash transactions. The basic principle of Murton's method of accounting was based upon the revolving fund approximating $3,000.00 at the end of

each year. If this were true, Murton's method of arriving at Petitioner's gross income, as found by the Tax Court, would necessarily result in Petitioner's income being fully accounted for. The essence of the Tax Court's finding is that Petitioner drew off and retained cash receipts in excess of the $3,000.00 revolving fund instead of depositing that excess in the bank, in accordance with his understanding with Murton. This conclusion is stated to be based upon an "analysis" of the record (246). Unfortunately, the "painstaking analysis of all of the evidence in this case" upon which the Court based its findings is not included in the opinion (244). The Court summarizes the various factors which the analysis took into consideration, but gives no specific figures derived from the individual factors. The Tax Court's finding upon reported income is based upon the volume of business inferable from the record, (241) but we are not told what that volume is.

(4) The Finding That Petitioner Substantially Understated Income from the Kingston Club Card Room Is Contrary to the Record and Raises an Issue Which the Respondent Has Conceded.

We are amazed at the Court's finding that the Petitioner substantially understated his income from the operation of the Kingston Club Card Room (221). The Court said (237), "No separate income, or loss, from the card room operation has been reliably established." The record shows that Petitioner kept full and accurate records of all income and disbursements in connection with the card room and Respondent has never questioned them in any respect whatso-

ever. The original books of entry, kept by Mr. Elbert Wright, an employee of Petitioners, are referred to in the record as the "gray books". In his opening statement, Counsel for Respondent called the attention of the Court and Counsel to the fact that the books were in Court and available for examination (20). The Court understood that the records of the card room were not in controversy (27). Monthly summaries, taken directly from the original books of entry, are in evidence in this case (68, 70, 80, Exhibit 8). The books were in Court, available for examination by Respondent's Counsel and revenue agents who were present. The summaries that were admitted in evidence were certainly adequate to reliably establish income from the operation of the card room where Respondent did not question their accuracy in any way. From the remarks made by the Court during the trial, Petitioner had every reason to believe that the Court understood that the accuracy of the card room records was not an issue in the case (149, 183). The Court's findings are to the effect that Petitioner's unreported income from the operation of the card room and the betting commissioner business did not exceed certain specified sums. However, there is no breakdown as to how much of the alleged unreported income is attributable to the card room and how much to the betting commissioner business. Since there is not the slightest question but that Petitioner maintained full, accurate and honest accounts of all of the card room income, this case should be remanded to the Tax Court with instructions that it make proper findings concerning the

card room and eliminate from the deficiencies found any portion thereof attributable to the Court's mistaken inclusion of unreported income from the card room.

(5) The Finding That the Petitioner in His Income Tax Returns for the Years in Question Substantially Understated the Income From His Activities as Betting Commissioner Is a General Conclusion and Is Not Specific or Definitive Enough to Enable the Court of Review to Pass Upon Its Validity (221).

The Court said, "We have no doubt from the record that the understatements for each year involved are quite substantial." (230). We respectfully submit that the record before the Court did not indicate understatements for any year. The Court found that the Petitioner's source of revenue was commissions on bets placed, and that he tried to get five percent on bets, except on horse races, where only the loser paid the five percent. Therefore, his maximum would have been five percent of the sums handled. However, the Court also found that he received only a half commission and in some cases no commission when he laid off the bets with other brokers. It also found that in horse race bets he received his commission only from the loser. It thus appears that if the Petitioner laid off a horse race bet with another broker, he would receive one-half of five percent from the loser's end only. Of course, horse racing is carried on in this country at some track or other the year around, and is the back bone of all betting establishments. Other athletic events are seasonable in nature and do not have the consistent devoted following that comprises the group that bets on horse races. It would

be very unreasonable to assume that after taking into account all of the things that the Tax Court said that it took into account to find that the Petitioner averaged more than two and one-half percent on all of the transactions that he handled. On this basis, the income that he reported for the three years in question would have required a total handle of $5,251,110.00. If he had made a full five percent on every transaction that he handled (which the Court concedes he did not) the handle would have been $2,625,555.00. If his commissions averaged out half way between the maximum of five percent and the more probable two and one-half percent, the handle would have been $3,939,322.50. Therefore, in the light of the Court's other findings, it is difficult to see how the Court could arrive at the conclusion that there were substantial understatements for each year involved. The Tax Court should be required to make specific and definitive findings, showing the amount of the total handle it estimated and the basis of that estimate, otherwise this Court has no basis for testing the validity of the Tax Court's general findings.

(6) The Finding That Petitioner Failed to Establish That His Income From His Activities as Betting Commissioner and His Operation of the Kingston Club Card Room Was Not Less Than $167,000.00 in 1948; $145,000.00 in 1949; and $108,000.00 in 1950 Is a Mere Conclusion Unsupported by Specific and Definitive Findings of Fact (221).

The Court found that Petitioner's gross income from his activities as betting commissioner and the operation of the Kingston Club Card Room for the

respective years in question did not exceed the following:

1948	$167,000.00
1949	145,000.00
1950	108,000.00

The Tax Court opinion then adds, "and that Petitioner has failed to establish a lesser amount".

Of course, we do not object to the finding that Petitioner's gross income did not exceed the amounts stated. The Court could well have gone further and found that Petitioner's gross income did not exceed the amounts stated in his income tax returns. We object to the statement that Petitioner has failed to establish a lesser amount on two grounds, first, the Respondent's determination was arbitrary and excessive and did not cast upon the Petitioner the burden of going forward, second, that the Petitioner did, in fact, establish a lesser amount. We believe that the Respondent's findings should be remanded for clarification and to be made more definitive. *Showell v. Commissioner,* 238 Fed. 2d 148, 50 A.F.T.R. 674. The error in the Tax Court's finding arises from the fact that a number of factors are grouped together, and the Court states that it took them all into account. We have no way of knowing how much weight was given to each factor, and whether they were properly taken into account. The Petitioner is entitled to know, for example, the amount of the gross receipts which was *assumed* by the Tax Court for the purpose of determining the Petitioner's commission. Next, the Petitioner is entitled to know what rate of

commission was used by the Court—how much at five percent, how much at two and one-half percent, and how much at any other rate that the Court may have used. The Court must have used some type of worksheet and compiled some figures in order to arrive at the maximums set forth in its findings. Unless we know the approximate weight that the Tax Court gave to the various factors which it took into account, it is impossible for the Petitioner, or the Court of Review, to analyze the validity of the finding.

(7) The Finding That Petitioner Received Commissions in Cash From Local Bettors in Amounts Not Less Than $69,000.00 in 1948; $60,000.00 in 1949; and $44,000.00 in 1950, is a General Conclusion, Not Supported by Specific, Definitive Findings of Fact (241).

This finding is subject to the same objections that we have made to the two findings discussed in the immediately preceding sections. The general finding is based upon computations and assumptions that are not stated. The Tax Court should be required to make specific findings, which will indicate the basis of the conclusion it reached.

(8) The Finding That Cash Received From Local Bettors Was Retained by Petitioner and Therefore Not Reported as Income Under Murton's Method of Reporting Income Is Contrary to the Evidence.

The Tax Court assumes that local bets would balance out in the long run, leaving cash in Petitioner's hands which would represent his commissions, less credit losses. From this the Tax Courts draws the completely unwarranted conclusion that this residue must have been received and retained in cash because

only about $25,000.00 in cash was deposited in the bank account. Of course, if cash had been retained by Petitioner in excess of the $3,000.00 revolving fund, it would not have been reported as gross income under Murton's system of accounting. However, there is no evidence whatsoever in the record that this was done. Petitioner's testimony on this point was direct, unequivocal and uncontradicted. This testimony, that any excess cash not required by the revolving fund and not deposited in the bank account was used to pay off bets, is uncontradicted and unimpeached. Petitioner's business was one single integrated enterprise. Not only were local bettors and local betting commissioners paid off in cash, but Petitioner was required to purchase Cashier's Checks and Money Orders to supplement the checks paid to out-of-town brokers. There is much evidence in the record to corroborate Petitioner's statements that he did not retain cash in excess of the $3,000.00 revolving fund. His personal expenses and manner of living during 1948 and 1949 came under careful scrutiny in the Parenti report. His manner of living and his net worth statement are entirely consistent with his returns as filed. Respondent argues that Petitioner might have cash in his possession which would not appear in his net worth statement because its existence would be unknown to Petitioner's accountants. The same conjecture could be made concerning almost any taxpayer, whether he maintained books and records, or not. The only basis stated for the Tax Court's conclusion that Petitioner must have retained cash is the volume of local business "inferrable" from the

record. As we have pointed out in our objections to other findings, the nature and extent of the inferences drawn by the Court are not stated in any specific findings. The fact that the amount of commissions earned by Petitioner from local bettors is estimated by the Tax Court as amounts in excess of the amount of cash deposited in the bank in no way indicates that those commissions did not find their way into the bank. For example, if Petitioner had a series of transactions with an out-of-town broker in which he received checks from that broker in the sum of $10,000.00 and paid losses in a similar amount to that broker in Cashier's Checks and Money Orders, purchased with cash received from local bettors, if the checks received from the out-of-town broker were deposited in the bank the net effect would be a deposit of the commissions earned in local transactions.

III. THE TAX COURT ERRED IN HOLDING THAT RESPONDENT HAS AFFIRMATIVELY PROVED THAT A PART OF THE DEFICIENCY IN EACH YEAR WAS DUE TO FRAUD WITH INTENT TO EVADE TAX.

The Tax Court's opinion correctly states the rules of law applicable to the fraud issue, i.e., "The burden of proof with respect to fraud is upon the Respondent, and he must establish fraud on the part of Petitioner by clear and convincing evidence." (243). "We recognize that Respondent cannot meet his own burden of establishing fraud on the basis of Petitioner's failure to discharge the burden of proving error in

the determination of deficiencies, and we do not, of course, rest our finding of fraud on that basis. The existence of fraud with intent to evade tax must be affirmatively established by Respondent." (244). Petitioner contends that having stated the applicable rules the Court did not correctly apply them to the facts of this case. The Court first found that Petitioner substantially understated his income for each year. It then inferred a fraudulent intent to evade taxes from (1) consistent understatement of income, (2) failure to maintain records of cash commissions, and (3) failure to inform his accountants of these cash commissions. Finally, the Court rejected Petitioner's testimony that his returns were correct and that Murton had told him that his method of accounting was satisfactory to the Bureau of Internal Revenue. It is respectfully submitted that both the Tax Court's findings and reasoning are erroneous.

(1) The Finding That Petitioner Substantially Understated His Income for Each of the Years in Question Is Not Supported by the Record.

Since this is a crucial point in this issue involving more than $91,000.00 in penalties, we will set forth the Tax Court's findings in full (224-246):

> "After a painstaking analysis of all of the evidence in this case, and bearing in mind the above stated principles, we are convinced that petitioner received taxable income during each of the years 1948, 1949 and 1950 from his activities as betting commissioner in excess of that reported on his returns for those years, and that in each of said years a part of the deficiency was

due to fraud with intent to evade taxes. It is well settled that respondent in sustaining his burden of proof of fraud, need not prove the precise amount of the deficiency attributable to such fraud, but only that a part of the deficiency is attributable thereto. *United States v. Chapman,* 168 F. 2d 997 (C.A. 7, 1948), certiorari denied 335 U.S. 853.

Taking into consideration the minimum volume of layoff bets indicated by the deposit of checks and money orders from out-of-town betting commissioners; undeposited checks and money orders from the same sources; checks of petitioner to betting commissioner; the fact that the remittances to and from petitioner usually represented the settling of accounts rather than individual bets; the added fact that petitioner's local cash business was a substantial part of his betting commissioner activities, recognizing the percentages he received (and making allowance for splitting of commissions on out-of-town business, occasional foregoing of commissions, occasional losses, and the fact that petitioner received commissions on horse race bets only from the loser), we reach the conclusion that there was a substantial understatement of income on petitioner's return for each of the taxable years in question. We cannot, on the record before us, determine the precise amount of such understatements, and we are not required to do so. However, after resolving any doubts in this respect against respondent, with whom the burden of proof of fraud lies, we hold, upon our analysis of the record, that the understatements were substantial for each year before us. Our analysis likewise convinces us that a large part of the understatements in each of said years was attributable

> to petitioner's failure to include in his return the receipt of commissions in cash."

The case of *United States v. Chapman* cited by the Court is a criminal case having no application to the imposition of civil penalties.

The Court states that "A part of the deficiency was due to fraud with intent to evade tax", but makes no specific finding of any specific deficiency. "Judgments in Tax Court cases, as in other cases, must have a reasonable basis on facts duly found by the Court". *Estate of Albert E. MacCrowe, et al, v. Commissioner* (4th Cir.) 1 A.F.T.R. 2d 58-886.

It is very clear that without the aid of the Commissioner's presumption, which the Court admits it relied upon in connection with its finding of an understatement of taxable income for the purposes of the deficiencies involved (244), there is no specific and definite evidence of any understatement whatsoever. Under the "Cohan" rule, the Tax Court has considerable latitude.

> "When the trier of fact disbelieves, or is not satisfied, that the claimed losses were sustained, he has a right to disallow the claimed deductions. Similarly, if he thinks that the taxpayer did suffer losses much smaller than claimed, but did suffer some losses, the taxpayer cannot complain if the fact finder selects a half-arbitrary, half-intelligent figure for the losses." *Showell v. Commissioner,* 238 Fed. 2d 148, 50 A.F.T.R. 674.

In determining the existence of fraud with intent to evade tax, all of the facts necessary to establish

the *deficiency and the fraud* must be clear and convincing. There is no evidence in this case of any specific deficiency. The Court says that its conclusion that there was a substantial understatement of income is reached after a "painstaking analysis of all the evidence", but none of the evidence referred to by the Court is sufficient to affirmatively prove, by clear and convincing evidence, that any deficiency existed.

The Tax Court says that it reached its conclusion as a result of a painstaking analysis, but it neglects to make any specific findings as to what its analysis disclosed. The Petitioner and the reviewing court are entitled to know what the Tax Court established in its own mind as the total volume of business transacted by Petitioner. We have pointed out, supra, that the income tax returns filed by Petitioner showed gross commissions which would have required a volume of business in excess of five millions of dollars. Of course, the actual volume of transactions that would be required to earn gross income in the amounts reported by the Petitioner would depend upon the percentage rate collected for commissions. This, in turn, would depend upon what allowance was made for splitting commissions, what allowance was made for foregoing commissions, and what allowances were made for occasional losses, and what allowances were made for the fact that commissions were received only from the loser on horse race bets. When the Tax Court has made findings on each of these points then, and then only, will this Court be able to as-

certain whether or not its conclusion is valid. It is obvious that the Tax Court failed to make those necessary findings because there was nothing in the record which it could use as a basis for such findings. The Court said, (245) "We cannot, on the record before us, determine the precise amount of such understatement . . .". The Court might well have said, We cannot on the record before us determine *any* specific amount of understatement. We think that it is clear that the Respondent failed to establish fraud on the part of this Petitioner by clear and convincing evidence.

(2) The Tax Court Then Listed Three Things Upon Which It Based Its Finding of Fraudulent Intent to Evade Taxes.

(a) The Court inferred a fraudulent intent to evade taxes from consistent understatement of income. The validity of this reason, of course, depends entirely upon whether the evidence before the Court would justify a positive finding unaided by any presumption that there was a consistent understatement of income. As we have shown in the preceding paragraph, the Court's findings do not warrant its conclusion of consistent understated income, so consequently, there can be no inference of fraudulent intent from that conclusion.

(b) The Tax Court also infers the existence of fraud from Petitioner's failure to maintain records of his cash transactions or of the cash commissions earned in such transactions. The evidence shows, without contradiction, that Petitioner had been told that his method of accounting was satisfactory to the Bu-

reau of Internal Revenue. The fact that Petitioner had been audited by Parenti for the years 1948 and 1949, and he had not objected to the Petitioner's method of accounting, shows that Petitioner had a reasonable ground for his belief. Whether anyone in the Internal Revenue Department ever gave Murton a letter or not, is immaterial here. Murton told Petitioner that he had such a letter and Parenti's audit was certainly calculated to convince Petitioner that Murton's statement was true. As we have noted earlier in this brief, Parenti's reports show that he had to know that Petitioner dealt largely in cash, and he had to know Murton's method of reporting income. The Tax Court brushes away the argument with the totally irrelevant observation that there is nothing in evidence "to the effect that the tax authorities, or Murton, ever advised Petitioner that it was not necessary for him to disclose to Murton the full amount of his commissions, or report them in his income tax returns". The short answer to this is that there is nothing in the evidence to the effect that Petitioner did not disclose the full amount of his commissions or report them in his income tax returns.

(c) The Tax Court also infers fraud from its finding that Petitioner withheld the full amount of his commissions from Murton. There is no specific evidence in the record to support this finding. This is necessarily another inference drawn from the Court's original conclusion that there was an understatement of income. Thus we see that this inference is also dependent upon the original conclusion of

understated income. Until the Respondent is able to produce clear and convincing evidence that will justify the Court in making specific findings upon which it can validly base its conclusion that there was understated income, all three of its inferences of fraudulent intent are invalid, because each one of them is dependent upon the assumption that there was an understatement of income.

(3) The Court Should Not Have Rejected Petitioner's Testimony to the Effect That His Returns Were Honest, Correct and Complete.

The Tax Court stated that it rejected Petitioner's testimony "Because analysis of the record demonstrates the contrary". Apparently this is still the same "painstaking analysis" which we have dealt with earlier. We do not know what the analysis demonstrates because we do not have the analysis. We have only the Court's statement that it made such an analysis and as a result thereof came to the conclusion that there was undeclared income for the years in question. Until the Tax Court is able to make specific findings in support of its conclusions, the Petitioner's testimony stands unimpeached and uncontradicted. A somewhat similar situation is found in *Denny York v. Commissioner,* 24 T.C. 742. After holding that the Commissioner was justified in using the bank deposit method to determine the Petitioner's correct income and tax liability, the Court said,

> "The unexplained deposits may, as the Petitioner testified and as the Commissioner has not disproven, have included some funds which were held but not in the bank at the beginning of the

> year. . . . The Petitioner did not satisfactorily explain the deposits, indeed he made little or no effort to explain them, but this failure of the Petitioner does not make up the deficiency in the Commissioner's evidence to sustain the burden of proof of fraud placed upon him by the Statute."

The Tax Court cites *Drieborg v. Commissioner,* 225 Fed. 2d 216, 47 A.F.T.R. 1830, and we think the following quotation from that case is pertinent to the issue here:

> "At the outset it should be emphasized that the failure of the taxpayers to overcome the presumptive correctness of the deficiencies, even though those deficiencies cover a consecutive ten year period, cannot be regarded, in and of itself, as sufficient proof that the deficiencies, or any part thereof, were due to fraud on the part of the taxpayers. To hold otherwise would be to ignore the Statute which imposes on the Commissioner the burden of proving fraud and the often repeated admonition that such proof must be by clear and convincing evidence. . . . *There must be additional independent evidence from which fraudulent intent on the part of the taxpayer can be properly inferred."* (Emphasis added).

The dissent of Pope J. in *Showell v. Commissioner,* supra, states the applicable rule in the following language:

> "It is elementary that a disbelief of a witness' testimony does not serve to supply evidence that is simply not to be found in the record. "But

disbelief of the engineer's testimony would not supply a want of proof." *Moore v. Chesapeake & O. R. Co.,* 340 U.S. 573, 576. "Nor can the district judge's disbelief of petitioner's story of his motives and fears fill the evidentiary gap in the Government's case". *Nishikawa v. Dulles,* 356 U.S. ....., 2 L. ed. 659, 78 S. Ct. (March 31, 1958). The case of *Dyer v. MacDougall,* 2 cir., 201 F. 2d 265, 269, is a reasoned explanation of why this is so. There Judge Hand was commenting upon the fact that many things might convince a judge that a witness' testimony was not only false but that "the truth is the opposite of his story", yet the court went on to say that in that situation a disbelief of a witness' story is no substitute for required proof of what the facts are. In that case the court held there was a fatal lack of available proof simply because there were no witnesses available to testify as to the facts alleged."

There is no independent evidence of fraudulent intent in this case. Every inference of fraudulent intent is drawn from the Tax Court's conclusion, unsupported by any specific findings, that the Petitioner understated his income from commissions. The Tax Court's reiteration throughout its opinion that it is basing its holding upon the "entire record" merely means that it cannot point to any specific evidence in the record which supports the Respondent's position.

CONCLUSION.

For the reasons given in the foregoing argument the judgment of the Tax Court should be reversed and these proceedings remanded to that Court with instructions that judgment be entered for the Petitioner.

Dated, San Francisco, California,
July 15, 1958.

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(Appendix Follows.)

Appendix.

Appendix

Exhibits	For Identification	In Evidence
Petitioner's 6*	41	41
7	60	60
8	61	61
9	73	73
10	92	92
11	151	151
Respondent's S**	170	170

*Petitioner's Exhibits 1 through 5 and Respondent's Exhibits A through R are attached to the Stipulation of Facts.

**The Clerk erroneously labeled this Exhibit "F".